

# Trust reformation

How the reformation of a trust can benefit the trustees and beneficiaries

Interviewed by Troy Sympson

**S**mart and savvy business owners are always prepared—in life and in death. They know that trusts are among the most valuable tools to ensure the future of their business and family.

But, even the best laid plans can face unexpected bumps. So what happens when a trustee or beneficiary needs to alter the language of an irrevocable trust and can't turn to the settlor for help because he or she may now be deceased? The answer is a legal proceeding known as a trust reformation.

"Trust reformations, when done right, can add value and help solve present or future problems with the administration of the trust," says Mark Sales, an equity member of Dykema Gossett PLLC. "If you properly plan, communicate and keep it friendly, both the trustees and beneficiaries benefit."

*Smart Business* spoke with Sales about trust reformations, how they work and when and why they should be utilized.

## What exactly are trust reformations and how do they work?

Typically, trust reformations involve modifying an irrevocable trust to address unanticipated changes that have occurred since its establishment or clarifying the language of the trust instrument for the benefit of trustees and beneficiaries. While you can't change an irrevocable trust just because you want to, a court can reform a trust for valid reasons. The law governing trust modifications has become more relaxed in recent years and there are now numerous permissible reasons for seeking a reformation. As an example, maybe one of the trustees died and the trust didn't provide a way for picking a successor trustee. Or perhaps there are so many trustees that administration of the trust has become unwieldy. There could be a change in family situation, like when the settlor's daughter is a beneficiary, her husband is a trustee, and then the two get divorced. Or there could be a need to react to market and economic conditions, such as declining real estate or changes to tax laws. For instance, we recently handled a trust reformation that allowed the trustees to diversify assets and have more flexibility in making investments while providing some protection from litigation if the investments did not perform as expected.

There are many reasons to consider a trust reformation. If the trustees and beneficiaries are interested in saving taxes or trustee fees, protecting or enhancing trust assets, providing more flexibility on investment of assets, changing the distribution scheme set out in



**Mark Sales**  
Equity member  
Dykema Gossett PLLC

the trust instrument or avoiding potential litigation because the terms of the trust are vague, they should consult with their estate planners or financial advisers on whether trust reformation is appropriate.

## What can cause a trust reformation to fall apart?

If you don't think things through and get everyone involved on the same page, something that was intended to be a friendly way to add value to the trust can turn into hostile litigation. Lawyers working on a trust reformation not only need to know the substantive law and procedural rules that apply to these matters, but also need to be able to negotiate emotional issues that can arise among the parties involved in the reformation, who may come from complex family structures.

For example, we have worked on several trust reformations in which service of process was required on infant minor contingent beneficiaries. We were able to avoid a process server going to the home by having the non-interested parent (informed ahead of time) accept the service papers (which start out with the not-so-friendly introduction: 'You have been sued'), and enter a voluntary consent to the reformation as next of friend to the minor. By doing this, we were able to avoid miscommunication and the cost and delay of having the court appoint an ad litem to represent the minor.

When everyone is on board and knows exactly what is being done, a trust reformation will achieve its desired results.

It's also important to note that special rules apply in certain reformation proceedings. For instance, many trusts have charitable remainder beneficiaries. A settlor wants to cover his children and grandchildren, then distribute the remainder to Baylor Hospital. When doing a trust reformation in these cases, you must give notice to the attorney general of the State of Texas and obtain a response to file with the court—typically a written statement that the attorney general declines to get involved in the proceeding. If you don't follow these rules, the trust reformation won't be allowed. And sometimes timing is critical in getting a response from the attorney general, for instance to take advantage of changes in tax law. Having a working relationship with the attorney general's office is essential to a successful reformation. Finally, reformations that try to take advantage of tax issues may need to be coordinated with obtaining a letter ruling from the IRS.

## When a trust involves a family business or other income-producing assets, what issues can arise?

In many trusts, the family business is a key asset. If a trustee controls ownership of that family business through the trust, you can run into various problems, such as tax issues. Or if you're the president of a company that's held in a trust and you're also one of the trustees, paying yourself a big salary or other benefits, another trustee or beneficiary may assert claims of self dealing, conflicts of interest and breach of fiduciary duty. A trust reformation can clarify what is or is not permitted, thus protecting against future litigation.

A different example is a family trust in which particular beneficiaries are minors who were not born when the trust was established or a class of individuals who may be born later. Yet their interests must be protected, and may actually not be the same as those of their parents. If the court appoints an ad litem to represent these minor or unborn contingent beneficiaries, the ad litem must agree to the trust reformation. It's imperative to the success of the reformation that counsel communicate with all beneficiaries, including parents and ad litem who may be appointed, and make sure there is agreement.

Most important, if you're going to do a trust reformation, do it for the right reasons, keep it friendly and civil and make sure the trustees, beneficiaries and all interested parties are on the same page. Then, all will gain that mutual benefit of a successful trust reformation. <<

**MARK SALES** is an equity member of Dykema Gossett PLLC. Reach him at (214) 462-6451 or msales@dykema.com.

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